United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

No. 75-7106

United States Court of Appeals

FOR THE SECOND CIRCUIT

MACAULEY WHITING,
Plaintiff-Appellant,

against

THE DOW CHEMICAL COMPANY,
Defendant-Appellee.

On Appeal from the United States District Court for the Southern District of New York

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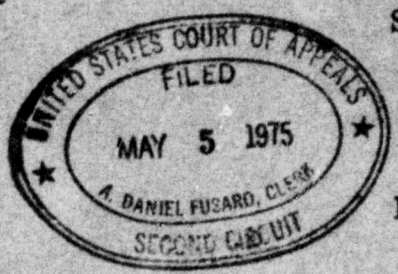
BRIEF FOR DEFENDANT-APPELLEE



ARTHUR F. MATHEWS, ESQ.
STEPHEN F. BLACK, ESQ.
WILMER, CUTLER & PICKERING
1666 K Street, N.W.
Washington, D.C. 20006
Tel: (202) 872-6000

PAUL R. GRAND, ESQ.
POLETTI FREIDIN PRASHKER
FELDMAN & GARTNER
777 Third Avenue
New York, New York 10017
Tel.: (212) 688-3200

Counsel for Defendant-Appellee
The Dow Chemical Company

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COUNTERSTATEMENT OF ISSUE PRESENTED FOR REVIEW

Whether on the facts of this case the district court correctly held that plaintiff-appellant Macauley Whiting ("Mr. Whiting"), a director of defendant-appellee The Dow Chemical Company ("Dow"), realized profits recoverable under Section 16(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78p(b), upon his

wife's sale and his purchase of Dow stock within a six-month period, where he derived benefits substantially equivalent to ownership from his wife's shares.

COUNTERSTATEMENT OF THE CASE

Nature of the Case

Mr. Whiting, a long-time director of Dow, sought a declaratory judgment that he was not liable to Dow under Section 16(b) as a result of his wife's sale of 29,770 shares of Dow common stock for $1,645,063.58 and his purchase within less than six months of 21,420 shares of such stock for $520,774, an amount "loaned" to him by his wife from the proceeds of her Dow stock sales. Dow counterclaimed for the profits realized upon the foregoing transactions, recovery of which was limited to $208,203.80 by Rule 16b-6 under the 1934 Act.

The controversy between the parties is legal, rather than factual: Mr. Whiting contends that for purposes of Section 16(b) no profits were "realized by him" from his wife's sale and his purchase of Dow stock—irrespective of his beneficial ownership interest in his wife's shares—because he did not exercise absolute control over the management and disposition of his wife's stock; Dow argues that Mr. Whiting did "realize" profits within the meaning of the statute because he derived benefits substantially equivalent to ownership from his wife's Dow stock in general and—as a result of the interspousal "loan"—from the very sales here at issue in particular.

Disposition in the Court Below

The district court, per Judge Ward, dismissed Mr. Whiting's complaint for declaratory judgment and awarded Dow the amount prayed for in its counterclaim.

The district court found, as matters of fact, that Mr. and Mrs. Whiting have been happily married since 1945

and maintain a common marital residence (A149);[1] that Mrs. Whiting pays "by far the largest share of the family expenses" from her assets, which consist principally of her Dow stock holdings (A148-49); that Mr. and Mrs. Whiting "file a joint income tax return which maximizes the deductions available to both" (A149); and that they and their children "benefit, in terms of style of life, from Mrs. Whiting's substantial wealth" (*id.*).

The district court further found, as a matter of fact, that although Mr. Whiting does not "control" the management of his wife's Dow stock, he and his wife "communicate concerning financial matters deemed mutually important" and have "demonstrated an ability to combine their actions where it is to their joint advantage." (A157.) In this connection, the court found that Mr. and Mrs. Whiting utilize the same financial advisers (A149); jointly attend meetings with these advisers to discuss the overall management of their estates and those of their children (A149-50); discuss the general philosophy which should govern the management of Mrs. Whiting's estate (A150); in 1972 agreed upon a "major" shift in that philosophy resulting in the formulation of a program for the annual disposition of certain percentages of Mrs. Whiting's Dow stock holdings (*id.*); and consult concerning investments in areas within Mr. Whiting's expertise (*id.*).

Finally, the district court found, as matters of fact, that Mr. Whiting consistently failed to disclaim beneficial ownership of his wife's Dow stock included in the "ownership reports" which he filed with the Securities and Exchange Commission ("SEC") (A158, 162 n.7); that Mr.

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[1] The following abbreviations will be used in this Brief: "A____" —Joint Appendix; "Br.____"—Brief of Plaintiff-Appellant; "DX ____"—Defendant's Exhibits; "PX____"—Plaintiff's Exhibits; "Tr.____"—Transcript of Trial.

and Mrs. Whiting were mindful of their general exposure under Section 16(b) (A158); that Dow specifically alerted Mr. Whiting to his potential Section 16(b) liability for his wife's transactions (*id.*); that Mr. and Mrs. Whiting were each generally aware of the specific transactions of the other here at issue (A157); that the pace of Mrs. Whiting's Dow stock disposition program was increased toward the latter part of 1973 (A157-58); and—last but not least—that Mrs. Whiting furnished Mr. Whiting with the funds necessary to make his purchase of Dow stock by extending to him a "loan" at seven percent interest "payable over an indefinite period of time" (A158).

On the basis of the foregoing facts as amplified by the record, the district court held that for purposes of Section 16(b) Mr. Whiting "realized" recoverable profits on the short-swing transactions here in question. Although Dow argued—and continues to maintain—that the sales and purchase at issue fall within the plain meaning of the statute, the district court found them to represent a class of "borderline transactions" as to whose coverage the language of Section 16(b) was ambiguous. (A154-55.) Guided by the Supreme Court's recent decision in *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 594-95 (1973), the district court held that "the policies of § 16(b) would not be served were this Court to consider it applicable only to transactions in a spouse's shares when the spouse is the 'alter ego' or agent of the insider." (A156.) Instead, the district court held that effectuation of the purposes of Section 16(b) requires that an insider be deemed to "realize" recoverable profits from short-swing transactions in securities of his spouse from which he derives "benefits substantially equivalent to ownership" within the meaning of the reporting requirements of Section 16(a):

> "The policies of automaticity and prophylaxis which underlie § 16(b) demand that the financial dealings of each spouse in the securities of a corporation of which one is an insider be attributable to the insider, where it is shown that the insider beneficially owns the spouse's stock for purposes of § 16(a) reports. To avoid liability the insider must demonstrate in some other way that the transactions, otherwise within the scope of § 16(b), generated no 'profits realized by him.'" (A156.)

Applying these principles to the facts before it, the district court concluded that the Whiting family situation was "of the sort to which § 16(b) is fairly addressed." (A159.)

Statement of Facts

A. *Preliminary Statement*

In Securities Exchange Act Release No. 7824, 31 Fed. Reg. 3175, 3176 (February 14, 1966)—quoted with "emphasis supplied" in Mr. Whiting's brief (Br. 24-25)—the SEC stressed that "the question whether liabilities under Section 16(b) will arise from transactions is, of course, to be determined by the facts of each particular case in an appropriate action brought by the issuer or its security holders." For reasons that should soon become obvious, Mr. Whiting chooses largely to ignore in his brief to this Court the essentially undisputed facts of record bearing upon the legal question here at issue. Dow submits that, in resolving the present legal dispute, it is critical for this Court thoroughly to understand the facts surrounding the transactions giving rise to this litigation.

B. *The Parties and the Transactions at Issue*

Mr. Whiting has been happily married to Helen Dow Whiting since 1945. Mr. and Mrs. Whiting have six

children and maintain a common marital residence in Midland, Michigan. Since 1959 Mr. Whiting has continuously served as a director of Dow. At all times relevant to this action, the common stock of Dow was a security covered by the provisions of Section 16(b) of the 1934 Act. (A9, 148-49.)

During September and November 1973 Mrs. Whiting sold an aggregate of 29,770 shares of Dow common stock, from which sales she received net proceeds totalling $1,645,063.58. On December 27, 1973, Mr. Whiting exercised an option, granted to him by Dow on June 10, 1969, and due to expire on June 10, 1974, to purchase 21,420 shares of Dow common stock at an aggregate option price of $520,774. (A9-10, 148.)

C. *The Financing of Mr. Whiting's Purchase: The Intrafamily "Loan"*

Mr. Whiting "borrowed" from his wife the entire $520,774 needed to exercise his Dow stock option on December 27, 1973. (A120-22, 158.) Mrs. Whiting obtained the funds utilized to make this rather unique "loan" directly from her September and November 1973 sales of Dow stock, the proceeds of which, having been temporarily invested in commercial paper, were transferred on December 26, 1973, from her account at Smith, Barney & Company, Inc. ("Smith, Barney") to her account at the Harris Bank & Trust Company of Chicago ("Harris Bank") to cover her check to Mr. Whiting. (A68-69, 82-84, 138, 158; Tr. 294-95; DX-NN, at 133-34.) As the district court expressly found (A157-58), both Mr. and Mrs. Whiting were aware at the time they agreed upon the intrafamily "loan" that the necessary funds would be available as a result of a recent acceleration of the program for disposing of Mrs. Whiting's Dow stock through her Smith, Barney account. (A44-45, 68-69; DX-JJ, at 141; DX-KKA, at 149.)

The intrafamily "loan" was unusual to say the least. In principal alone it exceeded $500,000, although in twenty-nine years of marriage Mr. Whiting had never previously borrowed as much as $10,000 from his wife (Tr. 286; DX-NN, at 131), if he had ever borrowed from her at all (Tr. 500-01). Mr. Whiting personally had never even borrowed as much as $25,000 from a bank. (A52-53.)

There were certainly no *bona fide* negotiations between Mr. and Mrs. Whiting with respect to any of the terms of the "loan." (A62-65.) In fact, the only "terms" agreed upon in addition to the principal amount were that a demand note would be executed and that interest would be set at a "reasonable rate" which supposedly would be "high enough" to assure "that this is a *bona fide* loan and not an inter-family special deal." (Tr. 356-57.) However, even these "terms" were not complied with until at least two months after consummation of the "loan," until after Mr. Whiting had become aware of the legal problems inherent in the transactions here at issue, and until after he had retained legal counsel to advise him and his wife concerning these matters. (A46, 50; DX-JJ, at 200, DX-KKA, at 166-69.) Thus, although the note evidencing the "loan" speaks as of December 27, 1973 (A122). it was in fact purposely backdated. (A46.)

At no time did Mr. and Mrs. Whiting have any discussions or negotiations concerning a maturity date for the "loan," the timing and method of its repayment, or the way in which Mr. Whiting—with an annual income of approximately $100,000 (A126)—would obtain sufficient funds to repay more than $500,000 in principal and interest exceeding an additional $35,000 for the first year alone. (A45-46, 63-65.) In fact, Mrs. Whiting

testified that she never even discussed or understood the annual amount of the required interest payment. (A65.)[2]

As the district court found (A158), upon determining to avail himself of a "loan" from his wife to fund his

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[2] Despite her denial (Tr. 552), the following testimony elicited upon cross-examination of Mrs. Whiting demonstrates that, when viewed as to substance rather than mere form, the transaction between Mr. and Mrs. Whiting had more of the attributes of a gift than a loan:

"Q. When you made the loan on December 27th, did you have any discussions with your husband about how it would be repaid? A. No. It was his business to repay me as he wished. I didn't see any point in discussing that.

* * * *

Q. Now, how about maturity? Was the note ever to mature? A. That I can't say.

Q. Did you ever have discussions with your husband as to how long the note would remain outstanding? A. No, I did not. I assumed it would be outstanding until it would be paid.

Q. Did you ever have any discussions with your husband about how often he would make installment payments? A. No. That was his business, not mine.

Q. You left it completely up to him? A. Of course.

THE COURT: In other words, you left him free to repay the loan at whatever time or times he wished in whatever amounts he wished?

THE WITNESS: That is correct. At a certain percentage per year.

THE COURT: And what was the percentage?

THE WITNESS: Seven per cent.

THE COURT: And how did that percentage come about? How was that arrived at?

THE WITNESS: That was his discussion with the Goldstein firm that they came to the conclusion 7 per cent was the right amount.

Q. So you didn't participate in any bargaining or negotiation with your husband or anybody at the Goldstein firm to set the interest rate? A. No. I did not.

THE COURT: He said 7 per cent is what Goldstein recommends, and I gather you said all right.

THE WITNESS: Yes, I did.

* * * *

Q. And as far as you were concerned if it took him forty years to repay it that would be have been all right? A. Yes, indeed." (A63-65.)

option exercise, Mr. Whiting discontinued his preliminary negotiations for bank financing, stating in a letter to the bank representative: "*We* have been able to get the cash required *from sale of stock* and will not need the loan at this time." (A88 [emphasis added].)

D. *Mr. Whiting's Pecuniary Benefits from His Wife's Dow Stock*

In 1973 Mr. Whiting's personal gross income from all sources amounted to approximately $120,000; in the same year Mrs. Whiting's personal gross income exceeded $3.7 million of which more than $3.5 million derived from dividends on, and capital gains from the sale of, Dow stock. (A124-26.) At all times relevant to this action Mrs. Whiting's income has greatly exceeded that of her husband. (A124-26, 148-49.)

As the district court found, Mr. and Mrs. Whiting have jointly chosen to pursue for themselves and their six children a highly expensive life style which Mr. Whiting could not afford on the basis of his own personal income. Consequently, Mrs. Whiting has consistently utilized the dividends on, and proceeds from the sale of, her Dow stock to pay the overwhelming majority of the expenses of maintaining the family home, educating the children, and otherwise providing for the high standard of living to which the Whiting family has become accustomed. (A148-49.)

Among the substantial benefits received by Mr. Whiting from the income on his wife's Dow stock was the use of such income to pay for basic family household and living expenses, including construction of the family home; substantial recent improvements and additions thereto, including a swimming pool; and day-to-day expenses for food, clothing for Mrs. Whiting and the children, laundry and dry cleaning, telephones, medical care for Mrs. Whiting and the children, drugs, dental care,

eyeglasses, pet care, books and magazines, sports and hobby equipment, and the salaries of the family cook, maid, laundress, and gardener and maintenance man. (A12-16, 70-71; Tr. 190-94; DX-JJ, at 216-27 and *passim*; DX-NN, at 142-48 and *passim*.)

In addition, Mr. Whiting has benefited continually and substantially from his wife's established practice of utilizing the income from her Dow stock to pay for the private school education of their six children, including tuition, room, board and related costs approximating $25,000 per year; the purchase, maintenance, and salary for the pilot of a private family airplane used extensively by Mr. Whiting; a substantial portion of family vacation expenses, including commercial air travel and the purchase of and certain maintenance with respect to the family vacation home; all real estate taxes on the family residence; a portion of the federal and state income taxes due on Mr. Whiting's income (to the extent that withholding from his Dow salary at "zero deductions" did not cover the taxes due on his salary, capital gains, and dividend and other income); and the fees of various financial and professional advisers for advice rendered to Mr. and Mrs. Whiting jointly, to Mr. Whiting personally, and to Mr. Whiting as trustee of trusts for the children and as president of the Macauley and Helen Dow Whiting Foundation. (A14-20, 38, 42, 46-47, 70-71.)[3]

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[3] In addition to the foregoing, Mr. Whiting has received and continues to receive a potpourri of other benefits from his wife's Dow stock. Of particular note are the annual gifts of approximately $6,000 worth of such stock which Mr. Whiting has received from his wife in every year since their marriage in 1945 and the current value of which now exceeds $1 million. (A20-21; PX-5.) In addition, Mr. Whiting is the beneficiary of approximately one-half of his wife's Dow stock under her will and, in light of the absence of any ante- or post-nuptial agreement (A41, 146), has a statutory *right* under Michigan law to a substantial share thereof. (Tr. 236-42, 259-61; DX-KK, at 54-58, 61.) Finally, Mr. Whiting receives the benefit of satisfying his natural desire to make gifts to charities through his wife's willingness to treat her charitable

[Footnote continued on following page]

The intrafamily "loan" utilized to finance the Dow stock purchase here at issue provided Mr. Whiting with particularly significant pecuniary benefits which flowed directly from his wife's Dow stock holdings. The "loan," funded with the proceeds of the very Dow stock sales here in question (A68-69, 82-84, 138, 158; Tr. 294-95; DX-NN, at 133-34), enabled Mr. Whiting to purchase 21,420 shares of Dow stock at approximately forty percent of its then market value.[4] The terms of the "loan" were most favorable to Mr. Whiting. The "loan" was unsecured, bore interest at the rate of seven percent, and had no specific maturity date (A122); by contrast, the Harris Bank of Chicago (Mrs. Whiting's bank), with which Mr. Whiting had conducted preliminary negotiations to obtain financing for his option exercise, would have charged Mr. Whiting interest at a rate of ¼% to ½% over its prime lending rate (then approximately ten percent) and required him not only to pledge all 21,420 shares of his option stock as collateral but to maintain $140,000 available in cash (A86).

E. *Joint Management of Mr. and Mrs. Whiting's Financial Affairs Through Common Professional Advisers*

Mr. and Mrs. Whiting have continuously utilized the same financial and legal advisers. Since 1957 Mr. Whiting has either himself selected, or has exercised a controlling influence over the selection of, these advisers and, in meeting and otherwise communicating with them, has exercised a controlling influence over the management and disposition of his wife's Dow securities.

[Footnote continued from preceding page]

gifts of Dow stock as "joint gifts." (A22-23, 128, 149; Tr. 129-32, 144-46, 150; DX-D, DX-E, DX-JJA, at 107A.)

[4] Mr. Whiting paid $24.3125 per share to exercise his Dow stock option on December 27, 1973 (A10); the closing market price for Dow stock on that date was $58.25 per share (PX-14); the net proceeds received by Mrs. Whiting on the Dow stock sales here at issue ranged between $57.37 and $54.88 per share (A82-85).

1. *The Freedman Relationship*

For approximately eight years after the death of her parents in 1949, Mrs. Whiting followed the long-standing advice of her father not to sell her Dow stock. Since her Dow holdings constituted virtually her entire assets at that time, she found no need to, and did not, retain the services of a professional investment counselor prior to 1957. When in 1957 Mr. and Mrs. Whiting jointly determined to educate their six children in private schools and realized that Mrs. Whiting would have to sell some of her Dow stock to meet the anticipated expenses, it was Mr. Whiting who selected Joseph Freedman—a friend who had long advised Mr. Whiting's grandparents—as the investment counselor to handle the sales of stock and to render general investment advice. (A30-31, 58-59, 71.)

In his initial letter to Mr. Freedman on October 6, 1957, Mr. Whiting solicited "help with the financial affairs of Mrs. Whiting and I," noted that "our financial situation" involves primarily Mrs. Whiting's Dow stock, and advised that "we" seek an opportunity for "trading on the equity," perhaps by borrowing money to purchase tax exempt bonds, adding that "in this way we would hope to realize a considerably greater income after taxes . . . ." (A96.)

During their fifteen-year relationship with Mr. Freedman, Mr. and Mrs. Whiting jointly attended every personal meeting with him. (A31, 98.) Mrs. Whiting did not participate actively in influencing the particular investment decisions which Mr. Freedman made on her behalf, and Mr. Freedman did not encourage her to do so. Instead, Mr. Freedman himself would formulate a particular disposition program, determine the number of shares to be sold, advise Mr. and Mrs. Whiting jointly at a personal meeting of the parameters of the recommended program, execute the transactions pursuant to full discretion as to timing, price, and amount, and apprise Mrs.

Whiting by letter of the results of each series of transactions after-the-fact. (Tr. 428-35, 486, 510-12.) According to a letter from Mr. Whiting to the financial vice president and treasurer of Dow, on at least one occasion Mr. Whiting caused Mr. Freedman to suspend sales of Dow stock by Mrs. Whiting due to inside information considerations. (A112.) *See also* p. 19, *infra*.[5]

From time to time Mr. Whiting prevailed upon his wife to reinvest proceeds from the sale of her Dow stock in securities which Mr. Freedman did not recommend. Such investments included two bank stocks and two tax-shelter programs. (A32-35, 69-70, 100-06, 130-32.) In fact, it was Mr. Whiting's success in persuading his wife to seek tax shelter investments—against Mr. Freedman's specific advice—and to pursue a generally more aggressive investment approach that first led to friction between Mr. Whiting and Mr. Freedman and ultimately resulted in Mr. Whiting's termination of the long-time counselor in August 1972. (A35-36, 69-70, 108, 140.) Like his initial letter to Mr. Freedman in 1957, Mr. Whiting's final letter fifteen years later stressed the man-

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[5] In addition to managing a program for the disposition of some of Mrs. Whiting's Dow stock, Mr. Freedman counseled Mr. and Mrs. Whiting as to the establishment of a family charitable foundation into which Mrs. Whiting could donate some of her Dow stock and of which Mr. and Mrs. Whiting would be officers (DX-MM-2, -3, -4, -5, -11, -12) and as to the creation of family trusts into which Mrs. Whiting could donate additional Dow stock and for which Mr. Whiting would serve as trustee (Tr. 197, 391-92; DX-MM-3, -11, -13, -18, -21, -22, -28, -29). Mr. Freedman also often communicated with Mr. Whiting, either directly or indirectly through Mrs. Whiting or her father's secretary (Mrs. Perry), as to Dow generally and transactions in, or advice relating to, Mrs. Whiting's Dow stock and the reinvestment or other use of the proceeds from the sale thereof. (*E.g.*, Tr. 320-21, 510-11; DX-H; -J, -K, -L, -M, -N; DX-MM-1, -2, -3, -4, -6, -8, -9, -10, -11, -14, -15, -16, -17, -18, -19, -20, -23, -24, -28, -30.)

agement of "our estate," the investments "we" consider very good, and the move "we" are making to new investment counselors. (A108.)

2. *The Smith, Barney Relationship and the Acceleration of Mrs. Whiting's Dow Stock Disposition Program*

Following Mr. Whiting's termination of Mr. Freedman, Mr. Whiting arranged for himself and his wife simultaneously to open in October 1972 discretionary accounts with the Capital Management Department of Smith, Barney under the supervision of one Mark Rickabaugh. (A47, 134; DX-JJ-1; DX-NN, at 29.) Smith, Barney through the single person of Mr. Rickabaugh rendered investment advice to the entire Whiting family, including Mr. and Mrs. Whiting, the children's trusts, the family foundation and, subsequently, the emancipated children. (A38; Tr. 200.) Mr. Whiting jointly attended every personal meeting with Mr. Rickabaugh (Tr. 446; DX-LL, at 34-35), and from time to time Mr. Rickabaugh attended meetings at Goldstein, Golub, Kessler & Company ("Goldstein, Golub")—the Whitings' tax advisers and estate planners—where Mr. and Mrs. Whiting and representatives of Goldstein, Golub jointly planned the family's financial affairs in an effort to maximize the after-tax income of the family unit. (A114-16; Tr. 322.)

From the very outset Smith, Barney advised Mr. and Mrs. Whiting that it considered Mrs. Whiting to be a "control person" of Dow by virtue of Mr. Whiting's position as a Dow director, and that it would treat her account accordingly. Mr. and Mrs. Whiting acquiesced in such treatment, and Mrs. Whiting thereafter regularly filed Form 144 reports with the SEC covering her sales of Dow stock. (A62, 137-39; DX-G-7, -8, -9, -13.)

Throughout the years during which Mr. Freedman had served as investment counselor to Mr. and Mrs. Whiting, no formal program existed for disposing of Mrs. Whiting's Dow stock; Mr. Freedman sold stock for Mrs. Whiting on an *ad hoc* basis whenever he concluded that timing, market, and other factors made such sales appropriate. (Tr. 428-35.) The determination to retain new professional advisers who would pursue more aggressive, tax-shelter oriented investment goals led to a concomitant decision to "formalize" the disposition program for Mrs. Whiting's Dow stock. (A37, 49, 54-55.) Mr. Whiting initially suggested that the disposition program consist of the sale of two percent of his wife's Dow stock each year, explaining that "the 2 percent figure would, based on the past performance of the stock, allow her holdings of Dow stock still to increase and expand and at the end of twenty years . . . she would have half of her holdings outside of Dow stock and . . . the size of her Dow stock holdings in dollars, would probably be larger than it was at the time." (A49. *See also* A40-41, 54-55, 60.) In fact, although implementation of the formal disposition program through Smith, Barney commenced in the fall of 1972 at the two percent annual rate, Mr. and Mrs. Whiting agreed, after consultation with Mr. Rickabaugh and representatives of Goldstein, Golub, that the rate should increase to five percent in the spring of 1973, further increase to ten percent in the fall of that year, and then revert to the original two percent rate until 1978. (A42-43, 61, 118. *See also* A150, 157-58.)[6] Mr. and Mrs. Whiting in-

[6] Apparently, the decision to increase the disposition rate from two percent to five percent in early 1973 was made upon advice from Goldstein, Golub that anticipated changes in tax laws in 1974 would make increased sales in 1973 more beneficial to Mr. and Mrs. Whiting. (A43, 118.) According to the testimony of both Mr. and Mrs. Whiting, the reason for the sudden redoubling of the rate to ten percent late in 1973 was Mrs. Whiting's displeasure at the requirement that she file Forms 144 covering sales of Dow stock

[Footnote continued on following page]

tended that the sales rate governing the disposition program for Mrs. Whiting's stock would be "subject to adjustment depending upon the growth and success of Dow Chemical Company" (A118) and would depend in part on their "estimate of the financial success, prospects for success or failure of the company" (A43-44).

3. *The Goldstein, Golub Relationship*

At about the same time Mr. and Mrs. Whiting determined to substitute Smith, Barney for Mr. Freedman as the family investment counselor, they also agreed to replace Arthur Andersen & Company with Goldstein, Golub as tax, accounting, and estate planning advisers. The primary purpose of the shift to Goldstein, Golub was Mr. Whiting's desire to pursue a more aggressive, tax-shelter oriented investment program. (A37-38, 108.)

Mr. and Mrs. Whiting jointly attended all meetings at Goldstein, Golub and received advice primarily from Stuart Kessler and his assistant, Martin Greif. At the initial meeting with Goldstein, Golub in April 1972, Mr. and Mrs. Whiting agreed that the firm would provide primarily tax and estate planning advice to the entire family unit, comprising Mr. and Mrs. Whiting, the six children, the children's trusts, and the family foundation. (A38, 42, 73, 114-18.)

In September 1972 Messrs. Kessler and Greif travelled to the Whiting family home in Michigan to obtain details concerning the investment, tax, and estate planning goals of Mr. and Mrs. Whiting. (Tr. 236-42, 266, 457-58; DX-KK, at 40, 68-77.) The "Estate Plan and Fi-

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[Footnote continued from preceding page]

(A43, 61); however, since Mrs. Whiting in fact first learned of, and prepared documents relating to, the requirement that she file Forms 144 at least as early as September 28, 1972 (A61-62; DX-G-7, -9), the timing of the increase of her sales to the ten percent rate in late 1973 might be better explained as a result of the need to generate sufficient cash to fund the "loan" which Mr. Whiting utilized in exercising his Dow stock option.

nancial Review" form completed by Mr. and Mrs. Whiting and Mr. Kessler at the meeting indicates that Mr. and Mrs. Whiting did not identify any separate or independent financial goals or objectives. (DX-R, at 6.) Among the additional subjects discussed at the meeting was the need for Mr. Whiting to exercise his Dow stock option by June 10, 1974. (Tr. 236-37; DX-KKA, at 68-71, 74.)

On three separate occasions—November 20, 1972, May 18, 1973, and October 29, 1973—Mr. and Mrs. Whiting met with Messrs. Kessler and Greif at the Goldstein, Golub offices in New York. The Goldstein, Golub "conference reports" of these meetings (A114-19), which Dow urges this Court to read, reflect Mr. Whiting's extensive participation in and controlling influence over the management of his wife's Dow stock. For example, at the meeting on November 20, 1972, discussion took place concerning the amount of Mrs. Whiting's Dow stock to be donated to the Whiting family foundation, the amount of Dow stock dividends to be distributed by the foundation, and a proposed procedure for utilizing dividends on Mrs. Whiting's Dow stock and a percentage of the proceeds from the sale thereof to fund quarterly estimated income tax payments for Mr. and Mrs. Whiting (A114-15); at the meeting on May 18, 1973, discussion took place concerning diversification of Mrs. Whiting's Dow stock holdings, Mr. Whiting's "concern about keeping a control on tax shelters and other non-marketable investments," and the need for Mr. Whiting to exercise his Dow stock option in 1973 in order to avoid the impact of anticipated adverse changes in the tax laws in 1974 (A116-17); and, at the meeting on October 29, 1973, discussion took place concerning the percentages of Mrs. Whiting's Dow stock to be sold in the years 1973 through 1978, the exercise of Mr. Whiting's Dow stock option, the possibility of utilizing "intra-family

borrowing" to fund the exercise of the option, and the "utilization of short-term trusts . . . to maximize after-tax dollars within the family unit" (A118-19).

F. *Mr. Whiting's Admissions of His Beneficial Ownership Interest in His Wife's Dow Stock*

Since January 1966 Mr. Whiting has regularly reported his wife's Dow stock as "directly owned" by him in the Form 4 ownership reports which he filed with the SEC. (A90; DX-C. *See also* A51, 158, 162 n.7.) Despite specific written notice from Dow's general counsel of the procedure for "disclaiming" beneficial ownership in his wife's stock (A23-24, 51-52, 76), Mr. Whiting never did so until after the problems here at issue arose (A24, 90, 162 n.7; DX-C). Nor has Mr. Whiting ever disclaimed ownership in the shares of his wife listed along with his in the Dow proxy materials which, as a director, he regularly reviewed. (A24.)[7]

In a letter dated April 26, 1972, to Dow's financial vice-president and treasurer, Mr. Whiting further ad-

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[7] Mr. Whiting's claim that he was misled by a 1965 memorandum (A74) and a 1966 memorandum (A76) from Dow's general counsel suggesting that Section 16(b) was inapplicable to option exercises (Tr. 38-45) obviously in no way lessens the significance of his admissions on forms filed with the SEC pursuant to Section 16(a). Moreover, the record amply supports the inference that Mr. Whiting subsequently received a 1968 memorandum (A78) and a 1969 memorandum (A80) from the general counsel correcting the earlier erroneous advice (Tr. 157-59) and clearly warning that option exercises were covered by Section 16(b) (Tr. 155-65; DX-G, at 26-32). Such an inference is particularly apt in light of the general counsel's testimony that in late 1968 he had specifically discussed with Mr. Whiting the applicability of Section 16(b) to the possible exercise by him of an option due to expire in early 1969 and the sale or contemplated sale by Mrs. Whiting of some Dow shares. (A92-93.) Furthermore, as the district court found (A158), Mr. Whiting received specific warnings from the general counsel that purchases and sales of Dow stock by him and his wife must be treated together for the purposes of the short-swing profits proscriptions of Section 16(b). (A28-30.)

mitted the basic indicia of his beneficial ownership interest in his wife's Dow stock. (A112.) Mr. Whiting's letter was in response to a letter from Dow's president to all officers and directors requesting that they advise Dow of any contemplated sale of Dow stock by any officer or director, "to make certain that there is not some possible adverse Company news in the offing that might make such a sale unwise from a potential liability or adverse publicity point of view. . . ." (A110.) Although only Mrs. Whiting was then engaged in selling Dow stock—Mr. Whiting has never sold a single share of the Dow stock in his own name (Tr. 221-23, 367-68)—Mr. Whiting responded as follows:

> "In response to Ben's letter of March 30 concerning the disposition of Dow stock by officers and directors, I would like to articulate *our family policy for such disposition* in order to forestall any suspicion of action based on inside information.
>
> It is *our intention* to dispose of between 2 and 3% of *our family holdings* every year for the indefinite future. This policy will mean a decrease in our share of the equity of Dow, but presumably the absolute value of our holdings will continue to grow.
>
> The timing of dispositions is under the control of *our* investment counselor. He has received from me no guidance as to when to dispose, except as in early 1971, *I suspended the disposition program* because of insider information considerations." (A112 [emphasis added].)

Such a letter cannot be rationally explained consistent with Mr. Whiting's claim that he had no beneficial ownership interest in his wife's Dow stock.[8]

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[8] Other evidence in the record demonstrating that Mr. and Mrs. Whiting have continually regarded and treated Mrs. Whiting's Dow stock as part of their "family" estate corroborates Mr. Whiting's admissions that he has a beneficial interest in her stock. For instance, since their marriage in 1945 Mr. and Mrs. Whiting have

[Footnote continued on following page]

ARGUMENT

I. The District Court Correctly Held that an Insider "Realizes" Profits within the Meaning of Section 16(b) from His Purchase and His Spouse's Sale of Securities from which He Derives Benefits Substantially Equivalent to Ownership.

Section 16(b) of the 1934 Act provides in pertinent part:

> "For the purpose of preventing the unfair use of information which may have been obtained by [a] . . . director . . . by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer . . . ." (15 U.S.C. § 78p [b].)

As this Court has repeatedly recognized, "the purpose of the statute is remedial, rather than penal, and . . . it must be strictly construed in favor of the corporation and against any person who makes a profit dealing in the corporation stock." *Adler* v. *Klawans*, 267 F.2d 840, 846-47 (2d Cir. 1959) (Burger, J., sitting by designation).[9] Indeed, "the theory of regulation underlying Section 16(b) requires the application of this section to

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[Footnote continued from preceding page]

continuously maintained their Dow stock, along with the Dow stock of the children's trusts and family foundation, in the same physical location to which Mr. Whiting always had access. (A25-26, 144.) Similarly, Mr. and Mrs. Whiting have regularly treated gifts of Mrs. Whiting's Dow stock as joint gifts for federal gift tax purposes. (A128, 149; DX-D, -E.)

[9] *Accord, Lewis* v. *Varnes*, 505 F.2d 785, 787-88 (2d Cir. 1974) ("Congress drafted § 16(b) . . . in order to create a 'prophylactic' effect."); *B. T. Babbitt, Inc.* v. *Lachner*, 332 F.2d 255, 257 (2d Cir. 1964) ("The statute is prophylactic in operation . . . ."); *Smolowe* v. *Delendo Corp.*, 136 F.2d 231, 239 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943) ("The statute is broadly remedial.")

every transaction that might possibly permit an insider to use inside information unfairly . . . ." *Blau* v. *Lamb*, 363 F.2d 507, 516 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967).[10]

As the district court below recognized (A152), courts have employed two tests in determining the applicability of Section 16(b) to the facts of specific cases: Where the operative statutory language is plain and unambiguous as applied to a particular transaction, the courts have utilized an "objective" or "bright-line" test and have interpreted the statute literally regardless of the arbitrariness or harshness of the result (*e.g.*, *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 424-25 [1972]; *Smolowe* v. *Delendo Corp.*, *supra*); on the other hand, where the operative statutory language is subject to alternative constructions as applied to a particular transaction, the courts have utilized a "pragmatic" or "possibility of abuse" test and, in order to mitigate the harsh effects of the statute, have construed Section 16(b) to cover only transactions subject to the evil which Congress intended it to prevent (*e.g.*, *Kern County Land*

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[10] To create a strong deterrent to short-swing trading by insiders, the statute requires disgorgement of profits realized on such transactions "without proof of actual abuse of insider information, and without proof of intent to profit on the basis of such information." *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 595 (1973). *Accord*, *Feder* v. *Martin Marietta Corp.*, 406 F.2d 260, 262 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970).

Because improper intent is irrelevant for purposes of Section 16(b), courts have uniformly refused to recognize "good faith" as a defense to an action brought under the statute. In *B. T. Babbitt, Inc.* v. *Lachner*, *supra*, for example, an insider charged with violating Section 16(b) by exercising an option to purchase stock within one week of his wife's sale of such stock proved that he had relied in good faith on SEC Rule 16b-3 which until 1960 had purported to exempt option exercises from the statute. This Court rejected the defense in light of a district court decision—unknown to the insider— which invalidated the Rule three months before the exercise in question. 332 F.2d at 259.

Co. v. *Occidential Petroleum Corp.*, 411 U.S. 582, 593-95 [1973]).

As we now show: (1) the plain language of Section 16(b) reaches short-swing transactions in securities from which an insider derives benefits substantially equivalent to ownership; (2) the district court properly resolved any statutory ambiguity by applying the "pragmatic" or "possibility of abuse" test to reject control as a limitation on attribution under Section 16(b); and (3) the district court correctly recognized a rebuttable presumption that an insider "realizes" profits upon short-swing transactions in his spouse's securities from which he derives benefits substantially equivalent to ownership.

A. *The Plain Language of Section 16(b) Reaches Short-Swing Transactions in Securities from which an Insider Derives Benefits Substantially Equivalent to Ownership.*

Section 16(b) imposes liability upon a corporate insider for any profit "realized by him" upon "any" purchase and sale or "any" sale and purchase of his corporation's non-exempt equity securities within less than six months. Read literally, the foregoing language plainly reaches short-swing transactions in securities from which an insider derives benefits substantially equivalent to ownership.

The term "any," as used to modify the phrases "purchase and sale" and "sale and purchase," unambiguously covers both transactions by the insider himself and by others. Congress could easily have limited the liability of an insider to profits realized by him upon "his" purchase and sale or "his" sale and purchase, but it did not do so. The broad reach of the phrase "profit realized by him" is similarly unambiguous. Almost by definition, an insider "realizes" profits on transactions in securities from which he derives benefits substantially equivalent

to ownership, particularly where such benefits include substantial proceeds from the sale of securities in question.

The courts have encountered little difficulty in holding that for purposes of Section 16(b) an insider "realizes" profits on short-swing transactions in securities in which he enjoys a beneficial ownership interest, even though a non-insider holds legal title to the securities and effectuates the transactions without the insider's knowledge. Thus, in *Blau* v. *Lehman*, 286 F.2d 786, 791 (2d Cir. 1960), *aff'd*, 368 U.S. 403 (1961), this Court held a director liable under Section 16(b) for his proportionate share of profits realized upon short-swing transactions in securities held in the name of a partnership of which he was a member, notwithstanding his express waiver and disclaimer of his share, his lack of knowledge of the transactions in question, and the absence of any improper use of inside information.[11] *Accord*, *Shattuck Denn Mining Corp.* v. *La Morte*, [1973-1974 TRANSFER BINDER] CCH FED. SEC. L. REP. ¶ 94,429, at 95,472 (S.D.N.Y. 1974). Similarly, in *Jefferson Lake Sulphur Co.* v. *Walet*, 104 F. Supp. 20, 25-26 (E.D. La. 1952), *aff'd*, 202 F.2d 433 (5th Cir.), *cert. denied*, 346 U.S. 820 (1953), the court held that for purposes of Section 16(b) a corporate insider "realized" and was liable for all profits on short-swing transactions, even though his wife owned an undivided one-half interest in such profits under applicable state law.

Indeed, as the district court noted (A156-57), in the absence of express waiver or disclaimer the courts have quite properly assumed that profits are "realized" for purposes of Section 16(b) by an insider who derives benefits substantially equivalent to ownership from se-

[11] The director did not seek review of this aspect of this Court's decision and, accordingly, the Supreme Court did not pass upon it. 368 U.S. 408 n.5.

curities of his corporation traded in short-swing transactions. For example, in *Blau* v. *Potter*, [1973 TRANSFER BINDER] CCH FED. SEC. L. REP. ¶ 94,115, at 94,477 (S.D.N.Y. 1973), the court recognized that "it is clear that if Mr. Potter [the insider] is the beneficial owner of the stock his wife purchased, he has realized a recoverable short-swing profit." Similarly, in *Marquette Cement Manufacturing Co.* v. *Andreas*, 239 F. Supp. 962, 966-67 (S.D.N.Y. 1965), the court proceeded directly to consider the beneficial ownership issue without even troubling to treat "realization" as a separate question. *See also Bershad* v. *McDonough*, 428 F.2d 693 (7th Cir. 1970); *Rothenberg* v. *Sonnabend*, [1961-1964 TRANSFER BINDER] CCH FED. SEC. L. REP. ¶ 91,226 (S.D.N.Y. 1963).

The circumstances in which an insider derives "benefits substantially equivalent to ownership" from his spouse's securities for purposes of Section 16(b) are equally plain. In defining the ownership reporting requirements of Section 16(a), the SEC recognized that an insider may receive such benefits in the form of *either* (1) the application of income or profits from the stock to maintain a common home or to meet expenses which the insider would otherwise have to meet from other sources ("pecuniary benefits"), *or* (2) the ability to exercise a controlling influence over the purchase, sale, or voting of the securities ("control benefits"). Sec. Ex. Act Rel. No. 7793, 31 Fed. Reg. 1005 (Jan. 19, 1966). Application of the "pecuniary benefits" test properly focuses on the nature of the benefits actually received, not the existence of an enforceable right to receive them. Feldman & Teberg, *Beneficial Ownership under Section 16 of the Securities Exchange Act of 1934*, 17 W. RES. L. REV. 1054, 1058-59 (1966). Application of the "control benefits" test properly focuses on the willingness of the spouse to vote, buy, or sell the securities as the insider may recommend. Shreve, *Beneficial Ownership of Se-*

curities Held by Family Members, 22 BUS. LAW. 431, 434 (1967).[12]

[12] Neither the 1934 Act, the related federal securities laws, nor the rules and regulations promulgated thereunder defines the term "controlling influence." The SEC's rules under the various statutes do, however, define the term "control" as follows:

> "The term 'control' . . . means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of any person, whether through the ownership of voting securities, by contract, or otherwise." (Rule 12b-2 [1934 Act]; Rule 405 [1933 Act]; Rule 0-2 [1939 Act].)

Broad as this definition is, the law is clear that " 'controlling influence [is] something less in the form of influence over . . . management or policies . . . than control' . . . ." *American Gas & Elec. Co.* v. *SEC*, 134 F.2d 633, 641 (D. C. Cir.), *cert. denied*, 319 U.S. 763 (1943). *Accord, Koppers United Co.* v. *SEC*, 138 F.2d 577, 581 (D. C. Cir. 1943); 2 L. LOSS, SECURITIES REGULATION (2d ed. 1961); Sommer, *Who's "In Control"?*, 21 BUS. LAW. 559 (1966).

The courts have given the term "controlling influence" an expansive interpretation. Thus, the concept of controlling influence essentially means " 'susceptibility to domination' " (*American Gas & Elec. Co.* v. *SEC*, *supra*, at 643 n.22), and "under some circumstances 'controlling influence may spring as readily from advice constantly sought as from command arbitrarily imposed' " (*id.*, at 642). *Accord, North American Co.* v. *SEC*, 327 U.S. 686, 693 (1946) ("Domination may spring as readily from subtle or unexercised power as from arbitrary imposition of command."); *Molybdenum Corp.* v. *International Mining Corp.*, 32 F.R.D. 415, 420 (S.D.N.Y. 1963); 2 LOSS, *supra*, at 775. Similarly, "latent power" is sufficient to constitute a "controlling influence," and "a controlling influence may be effective without accomplishing its purpose fully." *Detroit Edison Co.* v. *SEC*, 119 F.2d 730, 739 (6th Cir.), *cert. denied*, 314 U.S. 618 (1941). *Accord, Public Service Corp.* v. *SEC*, 129 F.2d 899, 903 (3d Cir. 1942); *Pacific Gas & Elec. Co.* v. *SEC*, 127 F.2d 378, 382 (9th Cir. 1942). As now SEC Commissioner Sommer has declared: "[E]ither *the power to control* or *the act of exercise of control*, even by the sufference of another who possesses the ultimate control, is sufficient to make a person a controlling person." Sommer, *supra*, at 565 (emphasis in original).

The SEC has long recognized the likelihood of "controlling influence" among family members. Thus, in *J. P. Morgan & Co.*, 10 S.E.C. 119, 146-48 (1941), the SEC rejected an argument by an indenture trustee that certain of its officers and directors were not in "common control" with an underwriter some of whose

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The district court properly found the SEC's interpretation of "benefits substantially equivalent to ownership" for purposes of the reporting requirements of Section 16(a) "useful" in determining whether an insider realizes profits upon transactions in his spouse's shares within the meaning of Section 16(b). (A156.) As one commentator has observed, "Sections 16(a) and 16(b) are necessarily interrelated. . . . Generally, if one is subject to the reporting requirements of Section 16(a) he is also subject to the short-swing profit limitations of Sections 16(b)." 3A H. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW § 10.01[3], at 10-4 (1974). Similarly, the Supreme Court has recognized the "interrelatedness of § 16(a) and § 16(b)" (*Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 426 [1972]), while this Court has acknowledged the authority that "§ 16(b) must be read in conjunction with § 16(a) in order to determine § 16(b) liability . . ." (*Feder* v. *Martin Marietta Corp.*, 406 F.2d 260, 268 [2d Cir. 1969] *cert. denied*, 396 U.S. 1036 [1970]).[13] Of course,

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preferred stock was held by their wives and children. The SEC pointed out that the trustee's argument "merely sets up the spectre of individuals controlling individuals, and proceeds to knock it down without touching upon the existing community of interests (pecuniary and otherwise) which, in our opinion, is so pertinent to the question of 'common control.'" 10 S.E.C. at 146-47. *See also S. T. Jackson & Co.*, Sec. Ex. Act Rel. No. 4459, at 14-22 (1950); 2 LOSS, *supra*, at 777-78.

[13] *Accord, Lewis* v. *Varnes*, 505 F.2d 785, 788 (2d Cir. 1974) ("§ 16(b) parallels the § 16(a) disclosure requirements . . ."); *American Standard, Inc.* v. *Crane Co.*, [CURRENT BINDER] CCH FED. SEC. L. REP. ¶ 94,924, at 97,190 (2d Cir. 1974); *Pappas* v. *Moss*, 257 F. Supp. 345, 366 (D.N.J. 1966); *Heli-Coil Corp.* v. *Webster*, 222 F. Supp. 831, 836 (D.N.J. 1963), *modified on other grounds*, 352 F.2d 156 (3d Cir. 1965). In light of these authorities and those cited in the text, the suggestion in *Marquette Cement Mfg. Co.* v. *Andreas*, 239 F. Supp. 962, 967 (S.D.N.Y. 1965), that Section 16(a) and the regulations promulgated thereunder have "only slight significance" in assessing Section 16(b) liabilities must be rejected.

the views of the SEC, which possesses broad rule-making authority over Section 16(b) as well as Section 16(a),[14] deserve careful consideration by the courts, for the Supreme Court has stated repeatedly that "the interpretation expressly placed on a statute by those charged with its administration must be given weight by courts faced with the task of construing the statute." *Zemel* v. *Rusk*, 381 U.S. 1, 11 (1965). *Accord, Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969); *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965).

In his brief to this Court (Br. 10-20), Mr. Whiting argues that Section 16(b) only reaches short-swing transactions in securities to which an insider holds legal title or over which he exercises absolute control. To support this contention, Mr. Whiting relies largely on cases holding Section 16(b) *applicable* to transactions where the insider actually controlled the purchase and sale of the securities in question or the person who effectuated the purchase and sale. *Mouldings, Inc.* v. *Potter*, 465 F.2d 1101 (5th Cir. 1972), *cert. denied*, 410 U.S. 929 (1973); *Feder* v. *Martin Marietta Corp.*, 406 F.2d 260 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970); *Blau* v. *Mission Corp.*, 212 F.2d 77 (2d Cir.), *cert. denied*, 347 U.S. 1016 (1954); *Alloys Unlimited, Inc.* v. *Gilbert*, 319 F. Supp. 617 (S.D.N.Y. 1970). Nothing in these cases stands directly or indirectly for the proposition that Section 16(b) *does not* reach short-swing transactions in securities from which an insider derives benefits substantially equivalent to ownership.[15]

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[14] Although the SEC has no enforcement role under Section 16(b), it has far-reaching powers to administer the statute by rule-making. See Note, *The Role of the Securities and Exchange Commission Under Section 16(b)*, 52 VA. L. REV. 668, 669-70 (1966).

[15] The case of *Truncale* v. *Blumberg*, 80 F. Supp. 387 (S.D.N.Y. 1948), upon which Mr. Whiting also relies, is wholly inapposite to the question here presented. The only "holding" in *Truncale* was that a gift is not a "sale" for purposes of Section 16(b). While

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The two remaining cases upon which Mr. Whiting principally relies to support his "control" argument in fact constitute persuasive authority for rejecting it. As discussed above (pp. 23-24, *supra*) and noted by the district court (A156-57), the courts in both *Blau* v. *Potter*, *supra*, and *Marquette Cement Manufacturing Co.* v. *Andreas*, *supra*, implicitly recognized that Section 16(b) imposes liability upon an insider who derives benefits substantially equivalent to ownership from securities of his corporation traded in short-swing transactions. In *Blau* v. *Potter* the court emphasized the significance of pecuniary benefits received by the insider from his wife's shares and, in holding Section 16(b) inapplicable to the transactions at issue, relied heavily on the testimony that "none of [the wife's] money is used to maintain the household in any way or to pay for any of her personal expenses or any of [the insider's] expenses." At 94,477. Similarly, in *Marquette* the court—while imposing liability upon the insider for short-swing transactions in a trust of which he was beneficiary—ruled Section 16(b) inapplicable to transactions in securities held by a corporation and various trusts from which he derived no benefits substantially equivalent to ownership and in securities held by his wife from whom he had been separated before the purchase in question and divorced before the sale at issue. 239 F. Supp. at 967.

In short, none of the authorities upon which Mr. Whiting relies in any way supports the proposition that Section 16(b) imposes liability upon an insider for short-swing transactions in his spouse's securities only when the insider exercises absolute control over his

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the court did suggest in dicta that a sale by a bona fide donee would not ordinarily result in a profit "realized" by the insider within the meaning of the statute, no such sale had in fact taken place, no facts considered by the court indicated that the insider retained a beneficial ownership interest in the donated securities and, accordingly, the court did not even address the question here at issue.

spouse's stock transactions. To the contrary, the plain language of Section 16(b), the SEC's interpretation of the interrelated reporting requirements of Section 16(a), and the pertinent case law all require that the statute be interpreted to reach all short-swing transactions in securities from which an insider derives benefits substantially equivalent to ownership.

B. *The District Court Properly Resolved Any Statutory Ambiguity by Applying the "Pragmatic" or "Possibility of Abuse" Test To Reject Control as a Limitation on Attribution under Section 16(b).*

Although Dow had argued—and continues to maintain—that short-swing transactions in securities from which an insider derives benefits substantially equivalent to ownership fall within the plain meaning of Section 16(b), the district court found the sales and purchase here at issue to represent a class of "borderline transactions" as to whose coverage the language of the statute was ambiguous. (A154-55.) Accordingly, the district court correctly applied the "pragmatic" or "possibility of abuse" test and, finding that acceptance of Mr. Whiting's "control" argument would thwart the policies underlying Section 16(b) (A156), properly rejected control as a limitation on attribution under the statute.

In *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973), the Supreme Court articulated the substance of the "pragmatic" or "possibility of abuse" test and the proper circumstances for its application as follows:

> "In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent—the realization of short-swing profits based upon access to inside information—thereby endeavor-

> ing to implement congressional objectives without extending the reach of the statute beyond its intended limits." (411 U.S. at 594-95 [footnote omitted].)

In *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 424 (1972), quoted with approval in *Kern* (411 U.S. at 595), the Court formulated the test and the conditions for its application in similar terms: "[W]here alternative constructions of the terms of § 16 (b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders."

In his brief to this Court, Mr. Whiting nowhere disputes the district court's finding that "the policies of § 16(b) would not be served were this Court to consider it applicable only to transactions in a spouse's shares when the spouse is the 'alter ego' or agent of the insider" (A156). Indeed, the legislative history of the statute [16] and numerous cases arising under it [17] amply demonstrate the danger that corporate insiders will seek to achieve short-swing profits in their corporation's stock by combining their own transactions with those of family members from whose shares they derive benefits substantially equivalent to ownership.

An insider's enjoyment of substantial pecuniary benefits from his spouse's securities traded in short-swing transactions alone creates a potentiality for the abuses which Section 16(b) was designed to prevent. As one commentator has perceptively observed, "there is the same incentive for and, in a sense, the same profit to be derived from trading in the company's equity securities

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[16] S. REP. No. 1455, 73d Cong., 2d Sess. 62, 63, 65, 68.

[17] *E.g.*, *Bershad* v. *McDonough*, 428 F.2d 693 (7th Cir. 1970); *B. T. Babbitt, Inc.* v. *Lachner*, 332 F.2d 255 (2d Cir. 1964); *Twentieth Century-Fox Film Corp.* v. *Jenkins*, 7 F.R.D. 197 (S.D. N.Y. 1947).

by the use of inside information on behalf of a family member as there is with respect to the direct holdings of the reporting person." Shreve, *supra*, at 434. Thus, an insider who receives substantial pecuniary benefits from stock held by his spouse may be sorely tempted either to utilize inside information in timing his own transactions in sequence with those of his spouse to realize short-swing profits for the "family estate" or, more blatantly, to impart inside information to his spouse with a view to realizing such profits. Since neither of these potential abuses is dependent upon the insider's "control" of the stock of his spouse, the purposes of Section 16(b) can only be effectuated by recognizing an insider's enjoyment of substantial pecuniary benefits from his spouse's stock as an independently sufficient basis for imposing liability upon him for profits realized on short-swing transactions in that stock.

Although an insider's enjoyment of "control benefits" [18] from his spouse's securities might not alone justify subjecting him to liability under Section 16(b),[19] the combination of such benefits with pecuniary benefits obviously establishes a firm case for imposing short-swing profit liability upon him. The ability of an insider to

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[18] *See* pp. 24-25 and n.12, *supra*.

[19] An insider who has the ability to exercise a controlling influence over the purchase and sale of his spouse's stock but who receives no financial benefit therefrom might not "realize" profits susceptible to recapture under Section 16(b). On the other hand, the ability to exercise a controlling influence alone clearly triggers the reporting requirements of Section 16(a) which seek to reveal market manipulations, lack of insider confidence, and abuses of the inside position in addition to short-swing transactions. Feldman & Teberg, *supra*, at 1072. Moreover, an insider who actually "controls" his spouse's securities but who derives no benefits therefrom would appear to be liable under Section 20(b) of the 1934 Act, 15 U.S.C. § 78t—the "controlling person" section—for profits realized *by his spouse* from short-swing transactions. *See also* p. 32 n.20, *infra*.

exercise a controlling influence over his spouse's purchases and sales of stock from which he derives financial benefit substantially increases the insider's power to reap short-swing profits from the securities transactions of his wife through the misuse of inside information. Thus, proof of an insider's controlling influence over his spouse's stock, while not necessary to bring him within the reach of Section 16(b), may provide significant corroborative evidence of the appropriateness of subjecting him to short-swing profit liability.

The district court correctly recognized that the broad remedial purposes of Section 16(b) would be thwarted by a construction limiting an insider's liability for short-swing transactions in his spouse's securities to circumstances in which the insider uses his spouse as a mere nominee or controls all the transactions in her securities. As commentators on Securities Exchange Act Release No. 7793 have declared:

> "The practice of placing property in the name of a spouse is a time-honored method of evading a variety of legal obligations. The release, however, is not directed solely toward such obtuse and highly unoriginal maneuvers, which obviously must be defeated if the section is not to become a complete mockery, but also it recognizes and reaches the more subtle, but equally important community of interest which normally exists among family members with respect to property management." (Feldman & Teberg, *supra*, at 1067.)

Dow submits that the same is true of Section 16(b).[20]

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[20] In a footnote elsewhere in his brief (Br. 8 **), Mr. Whiting attempts to argue from legislative history that Congress did not intend Section 16(b) to reach transactions of the type here at issue. The legislative history upon which Mr. Whiting relies in no way supports his contention.

Mr. Whiting first relies upon the misleading assertion that "a provision of the section which would have imposed liability for

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Unable to argue that short-swing transactions of securities from which an insider derives benefits sub-

[Footnote continued from preceding page]
transactions of the wife and others was eliminated from the statute as it was finally approved by Congress." In fact, the cited provision (S.2693, 73d Cong. 2d Sess. § 15[b][3]) would not have imposed short-swing profit liability upon insiders for transactions of their spouses but rather upon "tippees"— *i.e.*, persons (whether or not related to an insider) who receive material non-public information and engage in short-swing transactions. Obviously, congressional rejection of such a provision can hardly signify an intent to relieve insiders from liability under Section 16(b) for profits realized by them on short-swing transactions in securities from which they derive benefits substantially equivalent to ownership.

Mr. Whiting next relies upon a fragmentary reference to "provisions later [in the Act] to catch [an insider's] wife and children . . ." (*Hearings on S. Res. 84 . . . Before the Comm. on Banking and Currency*, 73d Cong., 1st Sess., pt. 15, at 6558 [1934]) as suggesting that an insider cannot be held liable for short-swing transactions in his spouse's securities unless he is a "controlling person" for purposes of Section 20(b), 15 U.S.C. § 78t. While Mr. Whiting correctly attributes to Section 20 the allusion to "provisions later [in the Act]," his sweeping inference from the quoted statement is impermissible. The question which elicited the statement was as follows: "Would it be possible for a man to *have* several people purchase this stock *for him*?" Since Section 20(b) prohibits any person from doing "through or by means of any other person" any act which he could not lawfully do himself, a response referring to the "controlling person" section was quite appropriate. Yet nothing in the legislative history or relevant case law suggests that Section 20 alone governs attribution under Section 16(b). Significantly, none of the cases upon which Mr. Whiting relies to support his argument that control is a prerequisite to attribution under Section 16(b) refers to Section 20 as the source of statutory liability. Moreover, as this Court has recently declared after an exhaustive review of the legislative history of Section 20 and the pertinent case authority: "We find it plain . . . that the 'controlling person' provisions were enacted to expand, rather than restrict, the scope of liability under the securities laws." *SEC* v. *Management Dynamics, Inc.*, [CURRENT BINDER] CCH FED. SEC. L. REP. ¶ 95,017, at 97,570 (2d Cir. 1975). An example of the type of transactions which Section 20 might reach—but which Section 16(b) standing alone might not—is short-swing trading in securities (held, perhaps, by an insider's wife or children or by a trust or charitable foundation) which the insider controls absolutely but from which he personally derives no pecuniary benefits and, accordingly, "realizes" no profits.

stantially equivalent to ownership do not carry a potential for the type of abuses which Section 16(b) was designed to prevent, Mr. Whiting contends that the "pragmatic" or "possibility of abuse" test is inapplicable to the type of transactions here at issue. Without offering any reasons to justify his position, Mr. Whiting argues that the test in question may be used only "to construe the words 'purchase' and 'sale' in the context of unusual corporate securities transactions" and cites without quotation or discussion numerous cases purportedly standing for this proposition. (Br. 21-23.) Neither the cited cases nor any valid legal principle supports Mr. Whiting's contention.

As noted above, the Supreme Court itself has declared the "pragmatic" or "possibility of abuse" test applicable wherever 'alternative constructions of the terms of § 16(b) are possible . . . .'" *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 595 (1973), quoting *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 424 (1972). Similarly, this Court has recognized that the test applies to cases "where the relevant provision [of Section 16(b)] is either intrinsically ambiguous or in which there are alternative plausible applications of the provision to a particular factual situation." *Lewis* v. *Varnes*, 505 F.2d 785, 789 (2d Cir. 1974).

Although the courts have encountered statutory ambiguity most often in construing the terms "purchase" and "sale" in the context of complex corporate securities transactions, they have also applied the "pragmatic" or "possibility of abuse" test to resolve other statutory ambiguities arising in other contexts. For example, in *Alder* v. *Klawans*, 267 F.2d 840 (2d Cir. 1959) (Burger, J., sitting by designation)—cited by the Supreme Court in *Reliance Electric* (404 U.S. at 424 n.4) as an example of the proper use of the "pragmatic" approach—this Court

applied the "possibility of abuse" test to determine whether Section 16(b) reached short-swing transactions by an individual who was a director at the time of sale but not at the time of purchase: "The objectives sought to be accomplished by Congress in adopting Section 16(b) . . . supply the key to the resolution of whatever ambiguity can be argued from other portions of the statute." 267 F.2d at 844.[21] Similarly, in *Booth* v. *Varian Associates*, 334 F.2d 1, 4 (1st Cir. 1964), *cert. denied*, 379 U.S. 961 (1965), the court fixed the date of an insider's purchase as the one "more likely to lend itself to the abuses the statute was designed to protect against." [22]

In the case at bar, the district court found the sales and purchase at issue to represent a class of borderline transactions as to whose coverage the language of Section 16(b) was open to several interpretations. (A154-55.)

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[21] At another point in its decision this Court emphasized its "pragmatic" approach: "[W]e construe this statute to be remedial, not penal, and hence subject to that *interpretation most consistent with the legislative purpose as that can be discerned from the statute itself and by resort to its history if that be needed.*" 267 F.2d at 844 (emphasis added).

[22] There is no merit in Mr. Whiting's additional argument (Br. 23) that "control" is an essential element of the "pragmatic" or "possibility of abuse" test. The cases cited by Mr. Whiting as authority for his contention simply stand for the proposition that no possibility of abuse exists where an insider's purchase or sale is completely involuntary. Indeed, as recognized in one of the very cases upon which Mr. Whiting relies, a danger of abuse *does* exist whenever an insider has "some measure of influence over the timing and circumstances of the transaction" sufficient to allow him to profit from the misuse of inside information. *Makofsky* v. *Ultra Dynamics Corp.*, 383 F. Supp. 631, 640 (S.D.N.Y. 1974), citing *Kern, supra*, at 597-600. As demonstrated below (pp. 43-49, *infra*), Mr. Whiting not only had "some measure of influence" over his wife's Dow sales but enjoyed the ability to exercise a "controlling influence" with respect thereto. Moreover, Mr. Whiting obviously had absolute control over the exercise of his Dow stock option which he was thus able to time in accordance with his wife's *earlier* Dow stock sales to reap maximum short-swing profits.

Mr. Whiting himself apparently agrees that a key statutory term is ambiguous as applied to the transactions in question, since he argues that "no 'sale' within the meaning of the statute took place." (Br. 4.) If a serious argument can in fact be made that only the disposition of stock by an insider himself (or by one over whom he exercises absolute control) constitutes a "sale" for purposes of Section 16(b), then surely the district court properly applied the "pragmatic" or "possibility of abuse" test to resolve the ambiguity and reject control as a limitation on attribution under the statute.

C. *The District Court Correctly Recognized a Rebuttable Presumption that an Insider "Realizes" Profits upon Short-Swing Transactions in His Spouse's Securities from which He Derives Benefits Substantially Equivalent to Ownership.*

The district court properly held that "where it is shown that an insider beneficially owns [his] spouse's securities for purposes of § 16(a) reports," he must be held liable for short-swing transactions in such securities unless he can "demonstrate in some other way that the transactions, otherwise within the scope of § 16(b), generated no 'profits realized by him.'" (A156.) The district court thus correctly recognized a rebuttable presumption that an insider "realizes" profits for purposes of Section 16(b) upon short-swing transactions in his spouse's securities from which he derives benefits substantially equivalent to ownership.

The "most important consideration" underlying the creation of a presumption is probability—*i.e.*, that "proof of fact *B* renders the inference of the existence of fact *A* so probable that it is sensible and time-saving to assume the truth of fact *A* until the adversary disproves it." C. MCCORMICK, EVIDENCE § 343, at 807

(2d ed. 1972). Thus, as Dean McCormick has suggested in analyzing the proper allocation of the burden of proof:

> "The risk of failure of proof may be placed upon the party who contends that the more unusual event has occurred. . . . Where services are performed for a member of the family, a gift is much more likely and the burden of proof is placed on the party claiming the right to be paid." (*Id.* § 337, at 787.)

Another important consideration which may justify recognition of a presumption is the need "to correct an imbalance resulting from one party's superior access to the proof." *Id.* § 343, at 806-07. Application of these basic evidentiary principles plainly supports the district court's recognition of a rebuttable presumption that an insider "realizes" profits for purposes of Section 16(b) on short-swing transactions in his spouse's securities from which he receives benefits substantially equivalent to ownership.

In his brief to this Court, Mr. Whiting argues at some length that the district court erred in relying upon an SEC release [23] recognizing a rebuttable presumption that for purposes of the reporting requirements of Section 16(a) an insider *beneficially owns* the securities of relatives with whom he shares a common home. (Br. 23-28.) [24] The short answer to this contention is that

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[23] Sec. Ex. Act Rel. No. 7793, 31 Fed. Reg. 1005 (Jan. 19, 1966).

[24] In support of his contention that he need not even have *reported* his wife's Dow stock under Section 16(a), Mr. Whiting quotes (Br. 26-27) Professor Loss as follows:

> "'And, even before the 1966 release, the obvious course—as simple as it was prudent—was to include the wife's and minor children's securities with the husband's (except in the event of a divorce or separation or, *perhaps since the 1966 release, a clear case in which the wife had always been the "monied" member of the family in her own right*), together with a disclaimer.' [5 L. LOSS, SECURITIES REGULATION, 3065 (Supp. to 2d ed. 1969), emphasis supplied and in original.]"

[Footnote continued on following page]

the district court nowhere approved a presumption of beneficial ownership—based upon the SEC release or otherwise—but rather recognized the entirely different presumption that an insider, who "is shown" to be the beneficial owner of his spouse's shares for purposes of Section 16(a), *"realizes" profits* on short-swing transactions in those shares within the meaning of Section 16(b). (A156.) As demonstrated above, recognition of such a presumption is proper and in full accord with the basic principles of the law of evidence.

But even if the district court erred in recognizing the rebuttable presumption which it did, such an error was entirely harmless and does not justify reversal. Both Mr. and Mrs. Whiting testified lengthily at trial on both direct and cross-examination, and the depositions of their financial advisers and of the general counsel of Dow were received in evidence. Mr. Whiting does not contend that he would have offered additional evidence had he known he bore the burden of proof on the "realization" question and, indeed, it is difficult to imagine what additional evidence he could have offered. The district court manifestly based its findings of fact and conclusions of law on the record as a whole and did not rely upon the allocation of the burden of proof in reaching a decision which, as Dow now shows, was plainly correct on the facts of this case.

[Footnote continued from preceding page]

Mr. Whiting thus misleadingly obscures the fact that Professor Loss emphasized only the word *"perhaps"* in analyzing the applicability of Section 16(a), thereby indicating his uncertainty as to the significance of a spouse's independent wealth. Moreover, Mr. Whiting relies upon an article by Mr. Shreve, a former SEC official, and remarks of a member of the New York Bar at a PLI conference (Br. 26-27) but misleadingly fails to note the following comment *by Mr. Shreve at the same conference*: "I do not think the fact that the wife had independent means was intended by the Commission to lead to the conclusion that the insider does not have to report her securities." PLI, DISCLOSURE REQUIREMENTS OF PUBLIC COMPANIES AND INSIDERS § 4.12, at 185 (FLOM, GARFINKEL & FREUND, EDS. 1967).

II. The District Court Correctly Held that Mr. Whiting "Realized" Profits within the Meaning of Section 16(b) upon the Short-Swing Transactions at Issue.

The district court properly applied the foregoing legal principles to the facts of this case. Its findings of fact and the undisputed facts developed in the record fully justify the legal conclusion that Mr. Whiting "realized" profits for purposes of Section 16(b) upon the short-swing transactions here at issue because he derived "benefits substantially equivalent to ownership"—in the form of both "pecuniary" and "control" benefits—from his wife's Dow stock.

A. *The District Court's Findings of Fact and the Undisputed Facts of Record Justify the Conclusion that Mr. Whiting "Realized" Profits upon the Transactions at Issue Because He Received Substantial "Pecuniary Benefits" from His Wife's Dow Stock.*

As discussed above, the SEC has identified as examples of pecuniary benefits substantially equivalent to ownership the "application of the income derived from [the] securities to maintain a common home [or] to meet expenses which [the insider] otherwise would meet from other sources . . . ." Sec. Ex. Act Rel. No. 7793, 31 Fed. Reg. 1005 (Jan. 19, 1966). The second example "would cover both legal obligations, such as support or education, as well as social or moral obligations . . . ," since "if this were meant to cover only legal obligations, presumably the language would refer to expenses which such person is *required* to meet." Feldman & Teberg, *supra*, at 1069 & n.65 (emphasis in original); *cf. J. P. Morgan & Co.*, 10 S.E.C. 119, 147 (1941). The courts have expressly recognized the significance of such benefits in determining whether an insider "realizes" profits from short-swing transactions in his spouse's securities for purposes of Section 16(b). *See Blau* v. *Potter*, [1973

TRANSFER BINDER] CCH FED. SEC. L. REP. ¶ 94,115, at 94,477-78 (S.D.N.Y. 1973). *See also* pp. 23-24, *supra*.

In the instant case, the district court found, as a matter of fact, that Mr. Whiting consistently derived substantial pecuniary benefits from his wife's Dow stock holdings. (A148-49.) As the record demonstrates, such pecuniary benefits included the application of dividends from, and proceeds from the sale of, Mrs. Whiting's Dow stock:

> (1) To pay for the construction of the family residence and substantial recent additions and improvements thereto (A12-14);
>
> (2) To pay all real estate taxes on the family residence (A14);
>
> (3) To pay ordinary household and living expenses for the immediate family including expenses for food, laundry, telephone, medical care for Mrs. Whiting and the children, drugs, dental care, eyeglasses, pet care, books, magazines, sport and hobby equipment, and the salaries of a cook, maid, laundress, gardener, and maintenance man (A14-16, 70);
>
> (4) To pay for the private education of their six children, including tuition, room, board, and related educational expenses approximating $25,000 per year (A14, 70-71);
>
> (5) To pay for the maintenance of a private airplane used extensively by Mr. Whiting, and for the pilot's salary (A16-18);
>
> (6) To pay a substantial portion of the family vacation expenses (A18);
>
> (7) To pay a portion of the federal and state income taxes due on Mr. Whiting's income (A18-20); and
>
> (8) To pay the fees of various financial and professional advisers for advice rendered personally to

Mr. Whiting and jointly to Mr. and Mrs. Whiting (A38, 42, 46-47).

At all relevant times, Mr. Whiting's personal income was insufficient to maintain himself and his immediate family in the manner to which they became accustomed (*cf.*, A124-26); indeed, Mr. and Mrs. Whiting determined that Mrs. Whiting should begin to dispose of some of her Dow stock in 1957 for the express purpose of generating sufficient cash to pay for the private education of their children (A59, 71). *See also* pp. 9-11, *supra.*

In addition to these rather ordinary pecuniary benefits which an insider might be expected to receive from his wife's stock, Mr. Whiting received a substantial pecuniary benefit of a rather extraordinary nature—the unsecured, reduced-interest "loan" (funded with the proceeds of the very Dow stock sales here at issue) of $520,774, which Mr. Whiting used to exercise his option to purchase 21,420 shares of Dow stock at approximately forty percent of its then market value. (A45-46, 62-65, 68-69, 82-84, 120-22, 138. *See also* pp. 6-9, *supra.*) To say that the terms of the loan were favorable to Mr. Whiting is somewhat of an understatement. (*See* p. 11, *supra.*) But obviously the most substantial—and for purposes of this case the most significant—benefit which Mr. Whiting received as a result of his wife's loan to him was his ability to use the proceeds of his wife's sale of Dow stock at a high price to purchase the same stock at a low price within a six-month period. Surely such a transaction has "the potentiality for evil inherent in all insider short-swing trading" [25] that Section 16(b) was designed to eliminate.

The record evidence of Mr. Whiting's substantial pecuniary benefits from his wife's Dow stock is so over-

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[25] *Newmark* v. *RKO Gen'l., Inc.*, 425 F.2d 348, 351 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970).

whelming as not to require further argumentation. As the district court declared relatively early in the trial: "[T]here is no question in my mind that over the past 20-odd years Mr. Whiting materially benefitted from his marital relationship with Mrs. Whiting, and if your adversary [referring to Mr. Whiting's counsel] is going to stand up and say he didn't, I would suggest to you that I could find that as a matter of law." (Tr. 192.) In fact, despite contentions to the contrary included in the Fretrial Order (¶¶ 13, 16, 17), Mr. Whiting's counsel conceded in open court that his client benefited substantially from Mrs. Whiting's Dow stock:

> "THE COURT: . . . .
>
> Do you argue the initial point of his having materially benefitted from his wife's registered ownership of some, I believe it is, 20 or 15 million dollars' worth of Dow stock?
>
> MR. BEATIE: It is 20 or more, your Honor. 20 is a conservative estimate, *and the answer is no.*" (A32 [emphasis added].)

Mr. Whiting's counsel never withdrew this concession.

Application of the legal principles discussed in Point I of this Argument (*see* pp. 22-27, 29-31, 36-37, *supra*) to the foregoing facts fully justifies the conclusion that Mr. Whiting "realized" profits for purposes of Section 16(b) upon the short-swing transactions here at issue as a result of receiving substantial "pecuniary benefits" from his wife's Dow stock. As Dow now shows, Mr. Whiting's liability under Section 16(b) is further supported by the district court's findings of fact and the undisputed facts of record which justify the conclusion that Mr. Whiting also derived substantial "control benefits" from his wife's Dow securities.

B. *The District Court's Findings of Fact and the Undisputed Facts of Record Justify the Conclusion that Mr. Whiting "Realized" Profits upon the Transactions at Issue Because, in Addition to Substantial "Pecuniary Benefits," He Also Derived Substantial "Control Benefits" from His Wife's Dow Stock.*

As discussed above, Securities Exchange Act Release No. 7793, *supra*, identifies as an alternative benefit "substantially equivalent to ownership" which an insider may derive from his spouse's stock "the ability to exercise a controlling influence over the purchase, sale, or voting of such securities." "Controlling influence"—connoting "susceptibility to domination"—means something less than actual "control" and " 'may spring as readily from advice constantly sought as from command arbitrarily imposed.' " *American Gas & Electric Co.* v. *SEC*, 134 F.2d 633, 641-43 (D.C. Cir.), *cert. denied*, 319 U.S. 763 (1943). *See also* n. 24-25 and n. 12, *supra*.

Although the district court determined that Mr. Whiting did not "control" his wife's Dow stock, it found facts fully justifying the conclusion that he enjoyed the ability to exercise a "controlling influence" over the management and disposition of her Dow shares. (A149, 150, 157-58. *See also* pp. 3-4, *supra*.) The undisputed facts developed during the course of these proceedings amply support the district court's findings in this regard and convincingly demonstrate that Mr. Whiting actually exercised a "controlling influence" over his wife's Dow stock.

The circumstances surrounding Mrs. Whiting's "loan" to Mr. Whiting of the full $520,774 required for the exercise of his option provides the single most striking evidence of Mr. Whiting's "controlling influence." Mr. Whiting actively participated with his wife in the meeting with the family's financial advisers on October 29, 1973, when discussion took place concerning the possi-

bility of an intrafamily "loan" to finance the option exercise. (A44-45, 118-19.) It was, of course, during this same meeting that the decision was made to increase Mrs. Whiting's annual sales of Dow Stock from five percent of her holdings to ten percent, an increase which in fact ultimately provided the cash necessary to fund the loan. (A45, 68-69, 157-58.) The terms of the "loan" itself were never negotiated in any formal or informal sense. Mrs. Whiting granted the family financial advisers complete discretion in determining the rate of interest which the "loan" would bear, and even at the time of trial was unable to testify as to the annual amount of interest she expected to receive. (A63-65.) Nor did Mrs. Whiting give any consideration as to how Mr. Whiting would repay the "loan," the annual interest on which alone amounted to one-third of his personal yearly pretax income. (A63-64, 126.) Not until after discovering the legal problems inherent in the transactions here at issue did Mr. Whiting even execute a note evidencing the "loan." (A46, 50.) And even at trial, Mrs. Whiting acknowledged that she had no concern as to when Mr. Whiting repaid her even if it took forty years or longer. (A64-65.) Such evidence can only compel the conclusion that in the management of her financial affairs generally and her Dow stock in particular Mrs. Whiting was "susceptible to domination" and under the "controlling influence" of Mr. Whiting in matters threatening the very abuses which Section 16(b) was designed to prevent. *See also* pp. 6-9, *supra.*

The "loan" transaction—though obviously of particular significance in the context of this case—is by no means the only evidence of the controlling influence exercised by Mr. Whiting over his wife's financial affairs and the disposition of her Dow stock. Indeed, the district court's findings and the undisputed facts of record demonstrate that throughout their married life Mr. and Mrs.

Whiting managed their financial affairs jointly, with Mr. Whiting often playing the lead role.

Since their marriage in 1945, Mr. and Mrs. Whiting have continuously utilized the same attorneys, accountants, investment advisers, broker-dealers, and tax and estate planners. (A36-38, 72-73, 144-45, 149.) In 1957 Mr. Whiting discussed and agreed with his wife upon the sale of a certain amount of her Dow stock to provide funds for the private education of their children. (A59, 71.) In the same year, Mr. Whiting arranged for his wife to employ Mr. Joseph Freedman—an adviser to Mr. Whiting's grandparents—as an investment adviser. (A30-31, 96.) During the fifteen years in which Mr. Freedman advised Mrs. Whiting, Mr. Whiting attended every personal meeting, communicated frequently with Mr. Freedman by telephone [26] and letter, and on various occasions persuaded his wife to invest in certain tax shelters and bank stocks contrary to Mr. Freedman's advice. (A31-35, 69-70, 98, 100-06, 130-32.) Significantly, according to a letter to the financial vice president and treasurer of Dow, in early 1971 Mr. Whiting "suspended the disposition program [of his wife's Dow stock] because of insider information considerations." (A112 [emphasis added].) *See also* pp. 12-14, 18-19, *supra*.

Because of his conviction that the family estate required more "aggressive" investment advice and tax counseling, Mr. Whiting wrote to Mr. Freedman in August 1972 terminating his employment. (A35-36, 69-70, 108, 140.) Mr. Whiting's termination of Mr. Freedman followed shortly upon his introduction of his wife to rep-

[26] The schedule of Mr. Freedman's diary (A98) demonstrates that during this period Mr. Freedman spoke by telephone forty-four times with Mr. Whiting alone, thirty-eight times with Mrs. Whiting alone, and once with Mr. and Mrs. Whiting jointly. Indeed, although Mr. Freedman was originally retained in 1957, the schedule of his diary establishes that he never had a single telephone conversation with Mrs. Whiting until almost seven years later in 1964!

resentatives of Smith, Barney—Dow's principal underwriter—and the accounting firm of Goldstein, Golub, which were retained in September and October 1972 to advise Mr. and Mrs. Whiting, their immediate family, trusts for their children, and the family charitable foundation. (A37-38, 42, 73; DX-KK, at 10.) Although Mr. and Mrs. Whiting opened separate accounts at Smith, Barney, the same individual—Mark Rickabaugh—exercised discretion over both accounts; Mr. and Mrs. Whiting jointly attended all personal meetings with Mr. Rickabaugh; and Smith, Barney billed Mr. and Mrs. Whiting jointly for the capital management fee due on their accounts until mid-1974. (A47; Tr. 446; DX-JJ-1, DX-LL at 34-35.) At Goldstein, Golub, Mr. and Mrs. Whiting maintained a single account (together with their children, the children's trusts, and the family foundation), received advice from the same individuals, jointly attended all personal meetings, and were billed jointly until mid-1974. (A73, 114-19; DX-KK, at 10, 32-39.) *See also* pp. 14-18, *supra.*

At approximately the same time that Mr. and Mrs. Whiting were discussing the shift from Mr. Freedman to Smith, Barney and Goldstein, Golub, they also expressly discussed a change in Mrs. Whiting's program for disposing of Dow stock. At Mr. Whiting's suggestion, they determined to "formalize" the existing disposition program into a plan whereby Mrs. Whiting would sell approximately two percent of her Dow holdings each year. Mr. Whiting arrived at the two percent figure on the basis of his belief that, in light of Dow's future prospects, such a program would result in Mrs. Whiting's retaining Dow stock equal in value to her then current holdings at the end of twenty years. It was at least in part on the basis of this rationale and in part on her general faith in Mr. Whiting's judgment that Mrs. Whiting determined to adopt the two percent disposition program. (A37, 40-41, 49, 54-55, 60.) *See also* pp. 15-16, *supra.*

Corroborating this proof of Mr. Whiting's controlling influence over the management of his wife's financial affairs is the abundant evidence that Mr. Whiting treated his wife's Dow stock simply as part of the "family estate." Thus, on April 26, 1972, Mr. Whiting wrote to Dow's financial vice president and treasurer "to articulate *our family policy* for such disposition [of Dow stock] . . . . It is *our intention* to dispose of between 2 and 3% of *our family holdings* every year for the indefinite future." (A112 [emphasis added].) *See also, e.g.*, A88, 96, 108. Similarly, since January 1966 Mr. Whiting continuously listed his wife's Dow stock as owned "direct[ly]" by him on his SEC ownership reports and knowingly refrained from filing a disclaimer of ownership under Rule 16a-3. (A23-24, 51-52, 76, 90, 162 n.7; DX-C.) Finally, Mr. and Mrs. Whiting acquiesced to Smith, Barney's insistence that Mrs. Whiting file Forms 144 as a "control person" in connection with any sale by her of Dow stock. (A62, 137-39; DX-G-7, -8, -9, -13.) Indeed, in 1973 Mr. and Mrs. Whiting discussed the applicability of Section 16(b) to any combination of purchases and sales by either of them (A28-29), although Mr. Whiting mistakenly then believed that the statute did not apply to the exercise of options. *See also* pp. 14, 18-19, *supra*.[27]

That Mr. Whiting treated his Dow stock as part of the "family estate" is hardly surprising. In every year since their marriage in 1945, Mrs. Whiting had given her husband Dow stock equal in value to the maximum annual gift tax exclusion (A20-21); Mrs. Whiting's will made her husband the beneficiary of a life estate in, and gave him a general power of appointment over, approximately one-half of her Dow stock (Tr. 236-42, 259-61;

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[27] Although Mr. Whiting possessed no right to control the voting of his wife's Dow stock, Mrs. Whiting has consistently voted her Dow shares in favor of the management-proposed slate of directors (which since 1959 has included Mr. Whiting) and all management proposals. (A53, 71-72.)

DX-KK, at 54-61; DX-NN, at 157); Mrs. Whiting named her husband as trustee of trusts for each of their six children, containing substantial Dow stock donated by her (A149; DX-JJA, at 35; DX-KKA, at 77; DX-MM-13); Mr. Whiting was president and Mrs. Whiting was secretary-treasurer of the Whiting family foundation whose assets consisted principally of Dow stock donated by Mrs. Whiting (A22-23; DX-JJA, at 122; DX-MM-12); Mr. Whiting regularly consented to have gifts of his wife's Dow stock to third parties treated as having been made "one-half by each" of them for federal gift tax purposes (A128, 149; DX-E; DX-KKA, at 79-81; DX-JJ, at 101-05; DX-NN, at 101); Mrs. Whiting regularly treated her charitable gifts of Dow stock as having been made "jointly" by herself and Mr. Whiting (A128, 149; DX-D, -F; DX-JJA, at 123-24; DX-NN, at 76, 102-03); and Mrs. Whiting maintained her Dow stock, along with that of Mr. Whiting, her children, the children's trusts, and the family foundation, in locations to which Mr. Whiting had access (A25-26, 144).[28] *See also* pp. 10 n.3, 19 n.8, *supra*.

Dow certainly has no intention of implying that the way in which Mr. and Mrs. Whiting managed their financial affairs was in any way improper; indeed, it was a most "natural" arrangement for two happily married individuals. Unfortunately, the commonplace nature of the manner in which they managed their affairs, their joint participation in major financial decisions and Mrs. Whiting's natural reliance on her husband's business and financial judgment compel the conclusion that they must be treated "as one" for purposes of Section 16(b). Under the legal principles discussed in Point I of this Argu-

[28] Mr. Whiting's controlling influence over his wife's investment affairs was not limited to her Dow holdings. For example, he served as his wife's "deputy" on the board of directors of Ware Corporation, a small company of which Mrs. Whiting was the largest shareholder. (A27-28.)

ment (pp. 22-27, 29-32, 36-37, *supra*), such evidence of Mr. Whiting's "controlling influence" over the management and disposition of his wife's Dow stock strongly reinforces the correctness of the district court's conclusion that Mr. Whiting "realized" profits within the meaning of Section 16(b) upon the short-swing transactions here at issue.

CONCLUSION

For the reasons stated above, the judgment of the district court dismissing Mr. Whiting's complaint for declaratory judgment and awarding Dow $208,203.80 on its counterclaim together with the costs of this action should be affirmed.

Respectfully submitted,

ARTHUR F. MATHEWS, ESQ.
STEPHEN F. BLACK, ESQ.
WILMER, CUTLER & PICKERING
1666 K Street, N.W.
Washington, D.C. 20006
Tel: (202) 872-6000

PAUL R. GRAND, ESQ.
POLETTI FREIDIN PRASHKER
FELDMAN & GARTNER
777 Third Avenue
New York, New York 10017
Tel.: (212) 688-3200

Counsel for Defendant-Appellee
The Dow Chemical Company

MAY 5, 1975

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 75-7106

Macauley Whiting,

Plaintiff-Appellant,

against

The Dow Chemical Company,

Defendant-Appellee.

AFFIDAVIT OF SERVICE

Arthur F. Mathews, Esq.
Stephen F. Black, Esq.
Wilmer, Cutler & Pickering
1666 K Street, N.W.
Washington, D. C. 20006
Tel: (202) 872-6000

Paul R. Grand, Esq.
Poletti Freidin Prashker
Feldman & Gartner
777 Third Avenue
New York, New York 10017

Counsel for Defendant-Appellee
The Dow Chemical Company

COUNTY OF NEW YORK
~~CITY OF WASHINGTON~~)
STATE OF NEW YORK)
~~DISTRICT OF COLUMBIA~~) ss.:

I hereby swear that I have this day served the foregoing Brief of Defendant-Appellee by delivering two copies thereof by hand to Russel H. Beatie, Jr., Dewey, Ballantine, Bushby, Palmer & Wood, 140 Broadway, New York, New York 10005, counsel for plaintiff-appellant Macauley Whiting.

Stephen F. Black
Wilmer, Cutler & Pickering
1666 K Street, N.W.
Washington, D. C. 20006
Tel: (202) 872-6000

Counsel for Defendant-Appellee
The Dow Chemical Company

Subscribed and sworn before this
5th day of May, 1975.

NOTARY PUBLIC

My Commission Expires: MAR. 30 1976

KENNETH F. HURLEY
Notary Public, State of New York
No. 30-7016010
Qualified in Nassau County
Certificate Filed in New York County
Commission Expires March 30, 1976

Index No.

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Case Caption

MACAULEY WHITING,

Plaintiff-Appellant,

- against -

THE DOW CHEMICAL COMPANY,

Defendant-Appellee.

Style of Pleading

AFFIDAVIT OF SERVICE

Counsel of Record

Stephen F. Black, Esq.
Wilmer, Cutler & Pickering

Paul R. Grand, Esq.
Poletti Freidin Prashker Feldman
& Gartner
777 Third Avenue
New York, New York 10017

Date

May 5, 1975

Of Counsel
WILMER, CUTLER & PICKERING
1666 K Street, N.W.
Washington, D. C. 20006
(202) 872-6000